



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

# DRAFT

Date:	04/15/13	Bill No:	<a href="#">Senate Bill 499</a>
Tax Program:	Property	Author:	Wyland
Sponsor:	Habitat for Humanity	Code Sections:	RTC 402.1
Related Bills:		Effective Date:	01/01/14

## BILL SUMMARY

The bill requires the assessor to consider the effect on value of a nonprofit organization-imposed restriction that limits a property to affordable housing use for at least 30 years. With this change, a property owner who buys a home from a nonprofit organization might pay less property tax than the law otherwise requires.

## ANALYSIS

### CURRENT LAW

**Purchase Price.** Existing property tax law requires the assessor to reassess property to its fair market value when it is sold. Revenue and Taxation Code (RTC) §110(b) provides that the “purchase price” for the property is rebuttably presumed to be its “fair market value.” It also provides that “purchase price” means the *total consideration* provided by the purchaser or on the purchaser’s behalf, valued in money, whether paid in money or otherwise.

Relevant to this bill, some government and nonprofit organizations’ affordable housing programs use silent second mortgages (silent second) to assist low-income home buyers purchase homes they could not otherwise afford. Typically, the silent second has no, or a deferred, repayment obligation.

When a home is purchased through an affordable housing program, “purchase price” can include more than the nominal sales price when the silent second is considered since “total consideration” is the measure of value.

**Enforceable Restrictions.** When determining a property’s fair market value, RTC §110(a) requires the assessor to consider the effect of restrictions on a property’s use, such as zoning or environmental constraints, that can be legally enforced. Similarly, when determining the value of land, RTC §402.1(a) requires the assessor to consider the effect of governmentally-imposed restrictions on land use. Except for certain easements granted to nonprofit organizations to preserve and protect land<sup>1</sup>, the assessor may not consider a nonprofit-organization imposed restriction that negatively impacts its value.<sup>2</sup>

Relevant to this bill, typically a nonprofit organization requires its home buyers to enter into a contract that limits the homeowner’s ability to sell, lease, refinance, encumber, or mortgage the home. The contract is recorded and could be legally enforced should the home buyer violate contract terms.

<sup>1</sup> RTC 402.1(a)(8)

<sup>2</sup> *Carlson v. Assessment Appeals Board No. 1* (1985) 167 Cal.App.3d 1004

**Determining Fair Market Value – Silent Second Mortgages.** Property tax law does not address how to determine value when the total consideration for a property includes a silent second mortgage. Relevant to this bill, in the case of silent seconds that involve a governmental agency, the BOE advises assessors to estimate the property's purchase price by adding the sum of:

- the down payment,
- the first mortgage face amount, and
- the assessor's estimate of the *present economic value* of the silent second reflecting all the agreement's terms and conditions. Such terms include whether the silent second will have to be repaid, repaid at the time of sale, or assumed by the next buyer.

After determining the purchase price, the assessor is required to consider the effect of any government-imposed restrictions on value. Specifically, the assessor exercises his or her judgment under RTC §402.1 to determine whether the property's value is equal to, or more or less than, the purchase price as a result of the enforceable government restrictions.

#### PROPOSED LAW

This bill adds to the list of enforceable restrictions that the assessor must consider when valuing land for assessment purposes, a recorded contract with certain nonprofit corporations<sup>3</sup>.

- The contract must restrict the land's use for at least 30 years to affordable housing or affordable rent, as specified.
- The nonprofit organization must: (1) have as its primary purpose the advancement of affordable housing, and (2) provide funding or land for affordable housing.

#### PREVIOUS LEGISLATION

Related to homes purchased by a homeowner under an affordable housing program, **AB 793 (Strickland, 2007)** would have:

- Excluded from the calculation of purchase price the amount of any "silent second mortgage" if payment is not required for at least 30 years.
- Expressly provided that resale price restrictions on homes purchased through a program operated by a governmental agency must be considered when determining property value.
- Allowed resale price restrictions on homes purchased through a program operated by a nonprofit organization to be treated as an enforceable restriction that must be considered when determining property value.

The Senate Appropriations Committee held that bill.

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<sup>3</sup>For purposes of this analysis, "nonprofit corporation" and "nonprofit organization" have the same meaning.

**COMMENTS**

1. **Sponsor and Purpose.** Habitat for Humanity is sponsoring this bill to allow the assessor to consider long-term affordability restrictions on the home, the actual purchase price, and the terms of sale, when assessing an affordable housing home made available to low-income families by similar nonprofit organizations. The sponsor states that, in 2007 it surveyed 22 counties regarding the process assessors use to assess affordable homes built, financed, and sold by Habitat affiliates. The results indicated a variance among jurisdictions. In some areas, the assessed value is based on whether or not the construction involved city or county funds, and in others, the value is based on verbal agreements with the local assessor.
2. **This bill allows assessors to consider any negative impact on value when nonprofit organizations impose restrictions on land use for at least 30 years to affordable housing or affordable rent.** When determining value for property tax purposes, the assessor may not reduce assessments to account for privately imposed use restrictions that negatively impact value. On the other hand, the assessor must consider any government-imposed restriction and any recorded contract involving a government agency. For nonprofit organization-imposed restrictions, the law provides one exception: an easement entered into between a private land owner and a nonprofit organization for an open space, scenic, or trail easement.
3. **This bill allows assessors to reduce the property tax value for homes sold in affordable housing programs run by nonprofits.** Without this bill, the assessor may assess the same home at different amounts depending on whether or not the buyer purchased the home from a nonprofit organization. As an example, if the total consideration for a home was determined to be \$100,000, and, in the assessors' judgment, the enforceable restriction negatively impacted land value by \$20,000, then the property tax value would be:
  - \$100,000 if purchased from a nonprofit organization, or
  - \$80,000 if purchased from a city's affordable housing program.
4. **This analysis focuses on homes sold with silent second mortgages because this has been an area causing concern.** Some argue that a home's "purchase price" should not take into account the silent second mortgage. However, because the law requires *total consideration*, whether paid in money or otherwise, to be the assessment basis, it must be considered. A mitigating factor is that the face amount of the silent second, which can be substantial, will be discounted. Once the assessor analyzes the silent second terms, it is possible that no amount, or a negligible sum, is added to the nominal sales price to calculate the statutory "purchase price" definition.
5. **Assessment of affordable housing sold when encumbered with silent second mortgages.** In 2007, the BOE set forth a [recommended approach](#) for homes sold by government agencies. The approach has two steps as explained in the next comment section. Without this bill, the approach's second step, which can result in a value reduction, cannot be used for homes sold by affordable housing programs operated by nonprofit organizations. This is so because the restriction limiting use is imposed by a nonprofit organization.

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*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position*

6. **The BOE recommends the following assessment approach.** First, the purchase price of the home must be determined which is estimated by adding the sum of:

- the down payment,
- the face amount of the first mortgage and
- the *present economic value* of the silent second reflecting all the terms and conditions of the agreements. Such terms would include whether, if at all, the silent second will have to be repaid at the time of sale, or must be assumed by the next buyer.

In practical application, the discount on a silent second, which may have a delayed payment as long as 30, 45, or an indefinite number of years, may be a **negligible sum**.

The second step in the process, which is the subject of this bill, is for the assessor to consider the effect upon value, if any, of enforceable restrictions on land use as RTC §402.1 requires.

This approach is administratively complex. The assessor must calculate a discount period and discount rate appropriate for the terms of the silent second term. Then after determining the purchase price, the assessor is required to consider the effect of the government-imposed restrictions on value. Specifically, the assessor must exercise judgment under RTC §402.1 to determine whether the value of the property is equal to, or more or less than, the purchase price due to the use restriction.

7. **Silent Seconds and Recorded Contracts Vary.** In the BOE's review of this issue, no standard or pro forma "silent second" was found. The specific terms and conditions of each silent second must be analyzed separately and independently to determine their respective property tax implications. Some silent seconds may only take effect if the purchaser violates the agreement, and are forgiven if the agreement is fulfilled. Such silent seconds operate solely as an enforcement mechanism to encourage compliance with the enforceable restrictions. In these cases, the BOE generally does not regard the silent second as part of the purchase price. In other cases, while the silent second may or may not have some enforcement goal, it nevertheless is payable whether or not the purchaser breaches the enforceable government restrictions. In such cases, where the purchaser has unconditionally committed to pay the silent second under its terms and conditions, the assessor must consider the silent second in the determination of the purchase price. Moreover, regulatory agreements related to the resale of affordable housing units also vary. Therefore, to determine whether enforceable restrictions have an effect on value, the assessor must review and analyze the agreement's specific restrictions and conditions as well as take into consideration the local marketplace for homes subject to similar or identical enforceable restrictions.

8. **It should be noted that the provisions of this bill are not specific to silent seconds.** The bill applies to any recorded contract restricting the use of land for affordable housing for at least 30 years. Additionally, the bill is not limited to housing that is sold; it also could apply to rental housing. Thus, more broadly, this bill treats a nonprofit organization-imposed restriction on affordable housing using a recorded contract the same as if the restriction was imposed by a government agency.

**COST ESTIMATE**

Costs to administer this bill would be absorbable.

**REVENUE ESTIMATE**

It is not possible to determine the revenue impact of this measure with any degree of certainty due to the number of variables. Each assessor must exercise his or her judgment under RTC §402.1 to determine whether the value of the property at that particular location is equal to, or more or less than, the purchase price as a result of the impact of the enforceable restriction placed by the nonprofit organization.

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